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European Financial Reporting Advisory Group (EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

Re: EFRAG European Sustainability Reporting Standards Exposure Drafts

Dear Board Members,

The Investment Company Institute (ICI), including ICI Global,[1] is writing to submit feedback on the Exposure Drafts for the European Sustainability Reporting Standards (ESRS).[2]

As the trade association representing regulated funds globally, ICI has a significant interest in how sustainability reporting standards for corporate issuers evolve. The development of these reporting standards, and their broad adoption, will ensure investors have accurate, comparable, and comprehensive sustainability-related information.

Fund managers need material financial information on companies' exposures to sustainability-related risks and opportunities, and how these are managed, to support investment decisions and enterprise valuations. Fund managers consider current performance as well as forward-looking matters that can be predictive of longer-term value creation. In addition, they use the information to pursue a range of investment strategies on behalf of the millions of retail investors around the world saving for retirement, education, and to achieve financial goals.

To help improve the quality and quantity of comparable sustainability-related financial information available to regulated funds and other investors, the ICI board issued a resolution encouraging US public companies to provide disclosure consistent with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and the standards of the Sustainability Accounting Standards Board (SASB).[3] Our members recognize that issues impacting financial performance of companies over time vary by industry. ICI believes that sustainability-related reporting standards will be most effective if they are designed within a rigorous and transparent framework with the investor in mind.

[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated investment funds. With total assets of $37.4 trillion, ICI's membership includes mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI Global has offices in Brussels, London, Hong Kong, and Washington, DC.

[2] Available at https://www.efrag.org/lab3?AspxAutoDetectCookieSupport=1.

[3] *See* ICI Board Unanimously Calls for Enhanced ESG Disclosure by Public Companies, available at https://www.ici.org/news-release/20_news_esg.

A global baseline of material information and the need for interoperability

ICI believes that the standards being developed by the International Sustainability Standards Board (ISSB) are well-situated to become the global baseline of sustainability reporting. The ISSB standards allow jurisdictions to build on this foundation while facilitating interoperability of their local initiatives, thus increasing comparability and reducing complexity.

Regulatory coordination is essential for the success of any reporting standards aimed at capturing sustainability-related information. Especially so, given the significant number of ongoing parallel policy initiatives relating to the measurement and disclosure of this information.

The reasons for prioritizing compatibility with other reporting standards are two-fold. First, interoperability will ensure that European companies and non-European companies within the extraterritorial application of the EU Corporate Sustainability Reporting Directive (CSRD) will not be subject to a double reporting burden with respect to disclosures of material information. Second, investors will not be left to resolve impractical inconsistencies in reported information.

We are encouraged by the EFRAG's efforts to align the draft ESRS with existing standards and we note that the draft final text of the CSRD now refers explicitly to integrating the ISSB standards.[4] However, we believe that for the EU to succeed in its goals,[5] it must continue improving the level of global collaboration on sustainability-related reporting. The need for *comparable* information cannot be overstated.

Compatibility with the ISSB standards

Simply put, the ESRS should integrate and build directly on the global baseline standards that are being set out by the ISSB. It is critical for the EU to endorse a common international language on disclosures to facilitate interoperability between different jurisdictional initiatives. This will limit unnecessary reporting burdens on companies and ultimately provide global investors with greater comparability and greater confidence in the reported information.

The ISSB standards, which incorporate the TCFD recommendations and the SASB standards, are designed to provide a robust global baseline of consistent, comparable information. The ICI notes that the SEC's proposed corporate sustainability reporting standards,[6] as well as existing standards

[4] *See* Recital 37 of the draft final text of the CSRD (https://www.consilium.europa.eu/media/57644/st10835-xx22.pdf), which provides that the EU's standards should contribute to the process of convergence of sustainability reporting standards at the global level by supporting the work of the ISSB, and that they should integrate the content of the ISSB's global baseline standards in order to reduce the risk of inconsistent reporting requirements for multinationals.

[5] The European Commission explained in its press release for the sustainable finance package on 21 April 2021 that the objective behind the measures, including the EU Taxonomy Climate Delegated Act and the CSRD proposal, is to "help improve the flow of money towards sustainable activities across the European Union". Press release available at https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1804.

[6] On March 21, 2022, the SEC proposed rules that would require public companies with periodic reporting obligations and companies filing registration statements to provide disclosures regarding greenhouse gas emissions, climate-related risks and impacts, oversight of climate-related risks, climate-related goals and climate-related financial statement metrics. *See* https://www.sec.gov/rules/proposed/2022/33-11042.pdf.

for companies with a standard or premium listing in the UK, are modelled on the TCFD recommendations.

We believe that the EFRAG should take a 'building blocks' approach in areas where the CSRD mandates capturing a broader set of information than the ISSB standards. This means using the ISSB standards as the overarching framework, and layering the ESRS's EU jurisdiction-specific requirements on top, where needed. Specifically, EFRAG should pay due regard to the ISSB standards in terms of architecture, definitions and methodologies. From the perspectives of our members, we have detailed a few particular areas of concern with the ESRS Exposure Drafts below.

Architecture

The EFRAG explains in its Basis for Conclusions documents accompanying the ESRS Exposure Drafts that it seeks "guidance from and coherence with […] existing standards", including the TCFD recommendations.[7] However, we observe that the ESRS as currently drafted does not follow the format of the TCFD recommendations, but rather proposes its own architecture.[8]

As a result, the four pillars of the TCFD recommendations (Governance, Strategy, Risk Management, Metrics and Targets) are cross-cut across different chapters of the disclosure requirements. For example, the disclosures categorized under a single pillar of TCFD recommendations may be spread out in disclosure requirements across different chapters.[9] Furthermore, we note that a single disclosure requirement, may also be relevant to different TCFD pillars.[10]

This divergence in architecture is likely to present significant challenges for corporate groups with global footprints that are subject to multiple corporate sustainability reporting regimes. For example, a global company would need to navigate discrepancies between the architecture of the ESRS and the TCFD (and by extension the ISSB standards, as well as standards already in force in the UK, and as proposed in the US by the SEC). This will create unnecessary friction and cost for preparers of disclosures in respect of what, ultimately, should otherwise be the same, or substantially similar, underlying content requirements.

[7] *See* e.g. Paragraph BC4(4) in the Basis of conclusions for ESRS 1 Exposure Draft "General Principles." (https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FBC%2520ESRS%25201%2520General%2520Principles.pdf).

[8] As seen in the Basis for Conclusions documents accompanying the ESRS Exposure Drafts, which summarise references to other standard setting initiatives or regulations used in developing the proposed contents of the Exposure Draft and provides tables to map out the relevant international framework references against each of the ESRS' disclosure requirements.

[9] TCFD Strategy (b) is currently set out in disclosure requirements across two chapters: Chapter 1 Disclosure Requirement 2 GR 3 *Key features of the value chain* and Chapter 2 Disclosure Requirement 2 SBM 4 *Interaction of risks and opportunities and the undertaking's strategy and business model*. *See* https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FBC%2520ESRS%25202%2520General%2C%2520Strategy%2C%2520Governance%2520and%2520Materiality%2520Assessment%2520ff.pdf.

[10] Chapter 4 Disclosure Requirement 2 IRO 1 *Description of the processes to identify material sustainability impacts, risks and opportunities*, relates to both TCFD Strategy (a) as well as TCFD Risk management (a). *Supra* note 8, above.

In addition, we are concerned that the structural differences in disclosure requirements will cause unnecessary confusion for global investors. Such investors require a consistent and compatible baseline level of sustainability disclosures and will likely struggle with interpreting and comparing information that is structured differently as between the ESRS and TCFD. In particular, this may cause difficulties for internal assessment frameworks if they are based on certain international standards.

Definitions

ICI strongly supports the ISSB's approach to materiality, particularly its focus on financial materiality and would urge EFRAG to adapt its definition of financial materiality to be consistent with the ISSB standards.[11] The ISSB standards are being developed with the objective of providing investors with sustainability information that is material for enterprise value creation. Keeping the ESRS compatible with the ISSB standards in this manner will help promote a consistent application of financial materiality across reporting entities.

While we recognize the interest in measuring the sustainability impact of companies, financial materiality and double materiality have distinct analytical lenses, serve different objectives and different sets of stakeholders, in an environment with limited global consensus. In this regard, we strongly recommend a much simpler definition of double materiality to support the ability of preparers and auditors of sustainability disclosures to implement the ESRS.

Methodology

It is important that the methodology and inputs for providing any quantitative or qualitative disclosures are kept consistent with other standards as much as possible to allow for efficient comparability across jurisdictions. We note that certain metrics, such as the disclosure of Scope 1-3 GHG emissions, appear to vary from other international frameworks such as the ISSB standards.[12]

[11] "An entity shall apply judgement to identify material sustainability-related financial information. Materiality judgements shall be reassessed at each reporting date to take account of changed circumstances and assumptions. An entity need not provide a specific disclosure that would otherwise be required by an IFRS Sustainability Disclosure Standard if the information resulting from that disclosure is not material. This is the case even if the IFRS Sustainability Disclosure Standard contains a list of specific requirements or describes them as minimum requirements." Page 34, paragraphs 59 and 60 of the ISSB General Requirements draft, *supra* note 2.

[12] We note that while the methodologies for calculating Scopes 1 and 2 emissions appear to be aligned, the ESRS leaves open the question of how to determine boundaries of the corporate group as regards unconsolidated subsidiaries, joint ventures, etc. By contrast, the ISSB exposure draft provides direction to preparers on how to approach corporate boundaries. Reported information, such as Scopes 1 and 2 GHG emissions, can vary significantly depending on how the corporate boundary is defined. This is an area where greater alignment is needed.

With respect to Scope 3, there are variances between the ISSB standards and ESRS in the disclosure of Scope 3 GHG emissions as well as the components for its calculation. The Exposure Draft for the ISSB standards propose that an entity should disclose upstream and downstream GHG emissions and if it includes emissions provided by entities from its value chain, it shall "explain the basis for that measurement" or "state the reason for omitting them" (Page 22, Question 9, Exposure Draft IFRS S2 Climate-related Disclosures). On the other hand, the ESRS proposes that an undertaking shall include a breakdown of its Scope 3 GHG emissions from: (i) upstream purchasing; (ii) downstream sold products; (iii) goods transportation; (iv) travel; and (v) financial investments (Disclosure Requirement E1-9 – Scope 3 GHG Emissions, ESRS E1).

In our view, the practical consequence of introducing additional level of detail or variances to methodology and reporting is that it will be counterproductive for stakeholders in the investment industry. It will increase reporting burden such that even the most sophisticated reporters may struggle to implement appropriate internal processes. Furthermore, it risks fragmenting global understanding of key sustainability and reporting concepts, which will create difficulties for investors when comparing metrics across jurisdictions.

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In conclusion, we strongly encourage EFRAG to support the interoperability of international frameworks by adopting a 'building blocks' approach to the global baseline of standards being developed by the ISSB. By doing so, companies will be able to efficiently disclose meaningful, comprehensive, and comparable information for investors and stakeholders. We believe that this approach will ultimately strengthen the ESRS' position as an effective standard.

We appreciate the opportunity to provide feedback on behalf of our members. We would be happy to discuss further any of our comments and further input that we can provide. If you have any questions, please contact me at Michael.Pedroni@ici.org or +1-202-853-2186.

Yours sincerely,

/s/ Michael Pedroni

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(https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf and https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FED_ESRS_E1.pdf, respectively.)